Corporation Finance and the Wage Worker

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THE primary object of any industry is production—production of commodities or of services. In these commodities or services three groups in society have an economic interest. These three groups are the capitalist whose money is invested, the worker who supplies the labor, and the consumer who pays the price for the commodity or service. As viewed from the welfare of these three classes, which combined comprise all members of society, the fundamentals of the finances of production should be a fair return to the owners of the capital, a fair wage to the possessors of labor, and a fair price to the consumers of the commodity or service. These finances should be so organized that the attainment of any two of these fundamentals or objects would automatically produce the third. That is, a fair interest or dividend and a fair wage should of themselves in combination result in a fair price; a fair interest or dividend and a fair price should of themselves in combination result in a fair wage; and a fair price and a fair wage should of themselves in combination result in a fair return to capital in interest or dividends.

If this is true then it is equally a fact that the prime essential of the finances of any corporation engaged in production is to show the actual true capital investment of money and services. If the finances do not show this—if the true capital investment is arbitrarily increased by paper capitalization and hidden or concealed by corporate organization and similar methods—then it is impossible to ascertain what is a fair return to any single one of the three elements to successful production. If, for example, only one million dollars of money and services are invested in a corporation, with its finances showing a capitalization of, say, ten million dollars, and an endeavor is made to pay a return on the ten million, there cannot possibly be a fair return on capital, a fair wage, and a fair price—every one of the three is most likely to be unfair. So at the very outset it is impossible, for any industry so capitalized

to supply the essential elements of fairness to the three classes interested in its production.[1]

The first questions that naturally will be asked are: What is a fair return on capital invested? What is a fair wage? What is a fair price?

The depositor in a savings bank receives three per cent interest. His savings have thrown about them the greatest possible security as to principal. He is satisfied with this low rate not primarily because the interest is a fair return—it may or may not be—but for the reason that he is concerned more in saving than he is in earning something from his savings. This investor is usually "inexperienced," or for various reasons as, for example, an executor of trust funds, has the security of principal as the prime object. Return on capital ranges in actual practice from this three per cent to almost any figure, depending largely upon the degree of risk to principal, or uncertainty in regular interest return, or simple speculation. This is merely to indicate that no arbitrary figure can be determined upon as a fair per cent return to all capital generally. Such a return can be ascertained, however, in almost any particular industry or business, and in most industries a particular rate has become established by which the return to capital in other industries is fairly measureable.

The same general statements are true with regard to what is a fair wage. Not all workers receive nor should they receive the same wage, even in the same locality or in the same trade or occupation. Thus in actual practice the return to workers in wages for labor performed varies relatively as greatly as does the return to capital. But in any particular occupation or locality most of the factors entering into the composition of wages, such as cost of food, clothing and shelter, are not so difficult of measurement as to prevent the determination of what is a fair wage to the worker from the family as well as the social viewpoint.

If it is agreed that invested capital should have a fair return and that in every industry the wage should be fair, then the price of a commodity or service would naturally adjust itself to these requirements—that is, the price would be such as to permit a fair

[1] The writer is familiar with the stock phrases that endeavor to justify overcapitalization, but all such arguments stress profits to the individual and not service to society.

return to the capitalist and to the worker. These latter having been ascertained the price automatically adjusts itself. In cases of industries where for economic reasons the price cannot bring a fair return to capital and labor, then if the needs of society demand this commodity or service the government should subsidize the industry through taxation sufficiently to produce these desirable results.

The determination of the return to capital or to labor cannot be left to each respective interested class. If it is, then one or the other or both remaining classes is or are disadvantageously affected. If the capitalist alone determines the return on his money he is likely to make it too high; if the worker alone determines the wage rate it also will likely be too high; if the consumer alone determines the price it is likely to be too low to permit of a fair wage and a fair return to capital. Nor can the determination of what is a fair return to capital, a fair wage, or a fair price be left to any two of the three parties interested in production because of the danger of a possible combination of class self-interest. Such determination can be arrived at only through the participation of all three parties interested.[2]

An industry having no accurate measurement of the amount of capital invested has no foundation upon which to base the determination of a fair return to capital, a fair wage, or a fair price. Such determinations for such an industry are impossibilities. And this is the situation that today confronts virtually every large industry in the United States. It reflects a condition which is the cause of complete lack of faith or confidence on the part of the great mass of organized wage-earners in the so-called financial reports of all our large corporations. This in turn has resulted in these wage-earners refusing to accept the reports that are made as in any honest degree reflecting the actual facts and in declining to accept these reports in wage discussions with employers and in arbitration proceedings as a basis for determining "the ability to pay" the higher wages or improved conditions of employment that may be demanded of the industry. In consequence, it is next to

[2] For the purpose of this paper the cost of management in salaries to executives, superintendents, and so on, which it might be desirable for other reasons to consider as a fourth factor in the cost of production separate and distinct from return to capital and labor, can be included in either group.

impossible for arbitration boards to render intelligent and just decisions in such cases. Perhaps this is one reason why arbitration through the intervention of the national government no longer has the confidence of railway employes.

This is reflected in the experience that has grown out of the numerous concerted wage movements during the past ten years and more of the four railway brotherhoods whose members are engaged in the operation of trains. The first of these movements, involving a large group of railroads in a particular geographical section, was in 1910. Down to 1913 one, if not the principal, defense of these transportation companies in opposition to the demands of their employes for higher wages and shorter hours of work, was "inability to pay." So persistent was this claim put forth by the railroads without specific proof of the assertion—other than the formal statistical presentation of their "property investment" and "capital obligations" accounts as taken from the reports of the companies to the Interstate Commerce Commission—and so insidious was its effect upon members of the board, that two of the railway brotherhoods determined upon an ascertainment of the facts, if it were possible to ascertain these facts.

For eight months a most exhaustive investigation was made by a staff of experts. The so-called "property investment" account of all the important railway systems of the United States was analyzed. Their intercorporate relations through stock ownership were also established and the effects of these relations upon the finances of the companies shown. Their so-called "capital obligations" account was gone into thoroughly; also the interrelation of all these companies with each other and with other industrial and financial corporations by means of interlocking directorates. No ascertainable fact that would throw light on the complicated situation was ignored. And when in 1913 the concerted wage movement of the Order of Railway Conductors and Brotherhood of Railroad Trainmen against the leading railways of the Eastern Territory came before the board of arbitration appointed by President Taft to settle the controversy, all this mass of data was presented before this board in statistical tables, charts, text explanations, and in the testimony of an expert witness. Then and there the Eastern railroads stated for the first time that they did not claim "inability to pay."

The sum and substance of this investigation by the railway brotherhoods is to condemn forever, before any fair-minded body of men, as utterly worthless the so-called "property investment" account as it appears today on the books of these transportation corporations. The same statement is true as to the alleged "capital obligations" account of these corporations—it is worse than useless as a fair measure of ascertaining the securities that have a just claim upon the earnings of the companies; it is actually misleading. These statements are verified by findings and rulings of the Interstate Commerce Commission. This, then, is the situation today with regard to the "official" statements of the railroads of the country as to the basis of their elaborate financial structure. This basis is unsound, unjust and misleading, not to use harsher terms. Consequently the railway employes have not the slightest confidence in the financial statements of railway corporations—the employes in their wage demands absolutely refuse to take into consideration any claims of the officials as to the corporations' finances.

If this condition exists with regard to the finances of our railroads, whose accounts are now kept according to rules of the Interstate Commerce Commission, are regularly inspected, and are far more subject to governmental authority than the accounts of other corporations, what is fairly to be expected as to other corporations virtually free in the adoption and employment of financial and corporate practices? The point is that there has been such misuse of the legitimate principles of corporation finance that in only exceptional cases of our large industrial enterprises is it possible to ascertain the facts essential to a just determination of a fair return to capital, a fair wage to labor, and a fair price to the consumer.

We see the injurious results of these general conditions in the present dangerous situation as regards our railroads. For years there has been a din and clamor in certain influential sections of the public for a so-called valuation of our railroads. Congress finally gave to the Interstate Commerce Commission authority to make this valuation. One of the instructions to the Commission in ascertaining this value was to report the original investment. The Commission's experts claim this to be an impossibility because even the railway corporations themselves assert that they

do not possess the facts as to the original investment. The constitutions of twenty-seven of our states and the common law in virtually all of them limit the issuance of securities to the amount actually invested in the property plus services and labor performed and declare null and void all securities issued over and above these items. Notwithstanding, the so-called investment market has been literally flooded with securities issued by these railroad corporations, which securities today stand as a "legal" claim not alone upon the earnings of these properties but also upon the properties themselves. Many of these securities are virtually piratical demands every six months forced from the passenger or shipper by means of the price of railway transportation that he is compelled to pay over and above the price or rate necessary to meet the legitimate cost of the service. This paper capitalization is an unjust burden upon the consumers of railroad transportation. As long as it continues, a fair price is an impossibility and an excessive return to alleged investment is the product.

The grim truth of the whole matter is that the corporate instrumentalities of production are not organized financially on a basis that will today permit the determination of what is a fair return to capital, a fair wage to labor, and a fair price to the consumer. The basis upon which they are organized is quite frequently a high return to capital, generally a low wage, and in many cases a high price.

Upon what principles can our industries be restored to a basis that will permit the determination of a fair return to the capital invested, a fair wage to the worker, and a fair price to the consumer? This is preeminently the problem for this generation to work out. He who claims to be able to supply a solution off-hand is too much of a braggart to be trusted. The forcible taking over of these industries by the government and their "nationalization" or "socialization" is being insisted upon by some. This action is based upon the right of revolution. That such a right exists in every society the writer will not deny, as it has been justified too many times in the past. The effective denial of this right would deprive the social organism of its last weapon or instrument of regeneration. Revolution, then, being the means only after all others have failed we should turn to the application of our best

thought to a plan for working out a peaceable adjustment. This, however, is not the place for such an attempt.

The writer at one time planned to work out as applicable to the railroads a scheme by which wages would be capitalized, from the point of view of return from profits, on an equal basis with the capital actually invested. This plan assumed a minimum wage for every employe based upon a comfortable standard of living. Wages above this minimum in the same and in different occupations in the industry were to be determined by the ability and efficiency of the individual worker, assuming as a starting point the basis arrived at through past competitive conditions. Each employe, after one year's regular employment, was to have issued to him an amount of stock equal to his annual wage and on this stock he was to receive the regular dividend, the same as a stockholder owning that amount of par value of stock representing capital actually invested. The theory was that a year's investment of labor in the industry was deserving of equal return with a year's investment of capital. There was also to be provision for the investment of the employes' savings in the securities of the corporation. Such a plan was never worked out in detail even theoretically for the very simple reason that it was not possible to ascertain the exact facts as to the actual investment of capital in the railroads. The so-called "property investment" and "capital obligations" accounts of the railway corporations as reported to the Interstate Commerce Commission were worthless as shedding any light on the facts.

The American workingman is suspicious of the financial practices of industrial corporations as to their investments and earnings. He will never be content with any so-called "profit-sharing" plan so long as corporation finances absorb by unjust capitalization methods a huge proportion of the earnings over and above those properly due to the capital invested. Such a practice verges close to actual fraud and explains in part why the American workingman has received so-called profit-sharing schemes with suspicion. Until a financial and corporate organization of industry is adopted and put into practice by American industries that will represent the facts of investment as they actually exist, the workers will continue to ignore the alleged financial statements of these industries. One of the very first reforms necessary in these

days of moral awakening as to rights and justice in the industrial world is the abandonment of past and present financial and corporate methods based on profits and the substitution of those that show the actual facts in relation to social service. Then, and then only, will profit-sharing, stock-ownership, participation in management, and like economic appeals possess to the workers the attractions inherent in their principles.

The effect of corporation finance in the past, which has involved among other practices the issuance of a tremendous amount of fictitious "investment," has been in the nature of a blanket mortgage exacting an unjust claim on the annual increase in wealth production. This increase should in justice be partly distributed among the people in lower prices and higher wages, but instead is being taken from them by the "legalization" of this fictitious investment. Much of it has been taken in the past through low wages to the worker. Now the European war has released this Titan from his bonds and he has risen to full stature and is today demanding his just share in wealth production. He is very likely not only to maintain but also to advance that claim successfully, which means that the burden of a continuance of past corporation practices will be shifted to the shoulders, or rather to the pocketbook, of the consumer through high prices. The consumer, being unorganized, will at first be unable to resist and will be subjected to a period of high prices until their exactions become so burdensome as to force him, also, into organization for his self-protection. Only when the worker and the consumer are each sufficiently organized, either separately or in combination, to resist the claims of organized capital will society reach that point where justice will be determined as between the "rights" of the capitalist, the worker and the consumer. Thus the organization of the consumer is the next step in the socialization of industrial production.

In the meantime there should be brought about in the public interest an agreement as to the financial principles that should form the basis of a present day valuation of virtually all our great industries. This is not the place to discuss this aspect of the problem except to say that these principles must rest upon public confidence by the adoption of just and fair methods for determining this valuation. Above everything else such a valuation must be open and above board with no hidden secrets or concealed claims of value that cannot stand the light of publicity.